

CASE COMMENTARIES

BUSINESS ASSOCIATIONS

Corporate counsel must serve all board members equally until sufficient adversity exists so as to remove any reasonable expectation that a director is a client of the board’s counsel; thus, the attorney-client privilege does not exist to limit informational rights absent sufficient adversity. *Kalisman v. Friedman*, C.A. No. 8447-VCL, 2013 WL 1668205, 2013 Del. Ch. LEXIS 100 (Del. Ch. Apr. 17, 2013).

By Brandon Whiteley

Delaware courts have adapted well to the quarrels that often erupt among the members of powerful boards of directors, recently having addressed new issues regarding the clash of director’s rights and corporate counsel during litigation. In *Kalisman v. Friedman*, the litigants filed opposing motions to the Delaware Court of Chancery to determine whether a corporation may invoke the attorney-client privilege or work product doctrine against a director on its own board.

Jason Kalisman (“Kalisman”) served as a member of Morgans Hotel Group Co. (“Morgans”) board of directors. Kalisman also co-founded OTK Associates, LLC (“OTK”), the largest single shareholder of Morgans, holding approximately fourteen percent of Morgans’ outstanding common stock. OTK made public its plans to replace all of the seated board members except for Kalisman. This spurred the remaining board members to craft a plan to recapitalize Morgans in order to prevent OTK from enacting its plot to unseat them. The directors did not inform their colleague, Kalisman, of the plan until the day before a Special Committee meeting to vote on the recapitalization, and during this meeting created a subcommittee of the Special Committee including each Special Committee member except for Kalisman. Following this vote, Kalisman brought suit against Morgans and all of the other directors, with OTK intervening. Kalisman subpoenaed all four law firms that represented Morgans, including the separate legal counsel for the Special Committee. Kalisman then filed a motion to compel, seeking a determination that Morgans could not invoke the attorney-client privilege or work product doctrine against him because of his position as a director. Kalisman sought to establish a three-tiered confidentiality system to prevent the disclosure of privileged information, which he alleged to have rights to as a director, from reaching his co-plaintiff OTK.

Directors hold an informational right regarding the corporation to which they owe a fiduciary duty. That right is “essentially unfettered in nature.” This

right includes access to privileged information, and all directors must have equal access to that information. The Court, therefore, found that Kalisman held informational rights as a director of Morgans in equal measure to the other seven directors taking actions behind his back.

The right of a director to access privileged information is not without limits, however. Delaware courts recognize three exceptions to this right. The first of these exceptions is that the director's right to information may be diminished by an *ex ante* agreement. No such agreement existed between the parties in this case.

The second exception, grounded in title 8, section 141(c) of the Delaware Code Annotated, allows for special committees and subcommittees to retain their own legal counsel. Even directorship does not allow for the breach of the attorney-client privilege between co-client members of the committee by any other board members not seated on that particular committee. Kalisman held a seat on the Special Committee, so this exception did not apply to him. However, the court opined that any exchange of information between the subsequent Special Committee subcommittee and its counsel would be protected by the privilege, assuming that the subcommittee formation was valid—an issue which the court did not consider for purposes of the motion at issue.

The third and final exception is that at the time when sufficient adversity exists between a director and the board or a committee, such that a director has no reasonable expectation that he or she remains a client of the board's counsel, the board or committee may invoke the attorney-client privilege against the director. While this may be a subjective measure, the nature of Morgans' seven directors' opposition to Kalisman and OTK remained secretive until the Special Committee meeting. The court noted that only days before the Special Committee meeting, Morgans' corporate counsel went so far as to deliberately conceal the other board members' activity from Kalisman. Unilateral adversity is no adversity at all, and the court held that in regards to the corporate counsel's farcical representation of Kalisman prior to sufficient adversity, "it would be inequitable to give [the defendants] the benefit of an earlier date for purposes of limiting Kalisman's informational rights." Accordingly, despite the possible exceptions the court considered, none of them applied to the matter at hand (excluding the potential application of the disregarded Special Committee subcommittee exception) to bar Kalisman from his rightful access to privileged information prior to the revelations giving rise to sufficient adversity during the Special Committee meeting regarding recapitalization.

Morgans and the other directors made two primary arguments against Kalisman's motion, and both fell flat. Firstly, they argued that Kalisman might

use the privileged information to cause injury to Morgans in breach of his fiduciary duty as a director, although they presented no concrete evidence on this point. The court disregarded this concern, explaining that “[i]f [Kalisman] does violate his fiduciary duty in this regard, then [Morgans] has its remedy in the courts.”

Secondly, Morgans and the other directors argued that Kalisman, as the shareholder representative of OTK, would unduly share privileged information. The court dismissed this argument as well, as represented shareholders are typically entitled to the same information as their representatives and Kalisman had already developed a three-tiered confidentially system to mitigate this concern. Although the competing motions argued both the attorney-client privilege and the work product doctrine, the court focused entirely on the attorney-client privilege and explained that the principles invoked under the attorney-client privilege apply equally under the work product doctrine so that no further explanation was required.

The Delaware Court of Chancery granted Kalisman’s motion and held that, lacking a proper exception, Morgans could not invoke the attorney-client privilege or work product doctrine to deny any of its directors, including Kalisman, access to information prior to the Special Committee meeting. Morgans could invoke its privileges against its own director only after this meeting because it had not created sufficient adversity to cause an exception to the attorney-client privilege or work product doctrine prior to that time. Until that meeting, and despite the secret motions of the seven directors in opposition to Kalisman and OTK, Kalisman remained a client of the four subpoenaed law firms under the employ of Morgans and retained all rights as a director.

This case brings to light an important lesson to corporate counsel, members of boards of directors, and litigation attorneys undertaking corporate law issues. For corporate counsel, if legal battles of this nature are to be avoided, then the first exception, *ex ante* agreements, may prevent undue headaches and provide an extra layer of defense against these kinds of attacks from within the boardroom, so long as the limitations on contracting away fiduciary duties are minded. Board members should use the example of Kalisman and Morgans to better understand the indivisible nature of duties and rights between corporations and boards of directors, as well as between members of the board and corporate counsel. Corporate counsel must serve the corporation, and hence all of its directors, until an exception arises from adversity or professional responsibility obligations. Secretive movements may be critical for protecting corporations

from the metaphorical warfare of the business world, but they must be performed properly in order to limit the corporation's exposure to the opposing forces within. Lastly, litigators embroiled in corporate litigation may find this manner of acquiring critical information either offensively or defensively useful. Harnessing the rights of directors to ensure due access to corporate information, or using the exceptions to keep unwanted directors out, may give a powerful boost to any case.

CONTRACTS

The UCC may be applied to a hybrid contract for both goods and services when the predominant purpose of the contract is for the sale of goods, as determined by the *Pass* factors. *Audio Visual Artistry v. Tanzer*, No. W2012-00216-COA-R3-CV, 2012 WL 6697600, 2012 Tenn. App. LEXIS 903 (Tenn. Ct. App. Dec. 26, 2012).

By Ashlee Mathis

In *Audio Visual Artistry v. Tanzer*, the Tennessee Court of Appeals was presented with the question of whether a contract providing for installation of technology systems into a home was a contract for goods or services. The court determined that a contract for a "smart home" integration system was one in which the predominant purpose was the sale of goods, and thus, the UCC applied to the contract. Distinguishing between a contract for the sale of goods and a contract for services is vital here because the Uniform Commercial Code (the "UCC") Article 2 only applies to contracts for the sale of goods. The application of the UCC dictates the types of warranties available to the purchaser and also the measure of damages for a breach. Furthermore, if the UCC applies to a contract for the provision of a system with multiple components, the purchaser would be required to pay for all the goods that were accepted; if the UCC does not apply, the purchaser would instead have a basis to argue that there was a right to withhold payment for any undelivered portion of the system.

In September of 2004, Audio Visual Artistry ("AVA") and Stephen Tanzer ("Tanzer") entered into a written contract for the purchase and installation of a state-of-the-art multimedia system in Tanzer's home. This system would have the ability to control Tanzer's home theatre, televisions, lighting, and phone systems in the house through an integrated control system. The creation of such "smart homes" through the sale of equipment and installation and integration of these components was AVA's specialty. The contract also allowed for changes to the plans for the system by providing a method for verbal

agreements and changes to be documented by AVA. In 2006, AVA began the installation process while Tanzer's home was under construction, and in April 2006, Tanzer moved into the house. After approximately fifteen months of installation and debugging of the system, Tanzer explained to AVA that there were still significant problems with the way the system was functioning. In August 2007, Tanzer fired AVA and asked for a final invoice to be sent to him. The final invoice showed a total cost of \$119,402.15 with a remaining amount owed of \$43,824.55. Tanzer disputed the amount due to AVA for the work completed, and as a result AVA filed the instant suit for breach of contract on November 19, 2007.

The trial court found that the contract in question was of hybrid nature, including both goods and services. The trial court applied the "predominant purpose" test and determined that the contract was primarily for the sale of goods, which would, in turn, be governed by the UCC. After determining that the UCC Article 2 controlled the contract, the trial court entered a judgment for AVA in the amount of \$23,982.55, which was later amended to \$35,580.55. Tanzer filed a motion to stay the judgment pending an appeal to the Tennessee Court of Appeals.

On appeal, Tanzer raised several issues for review; however, the most pertinent issue was whether the trial court erred in determining that the UCC applied to the contract with AVA. Tanzer asserted that the contract was primarily for services, and thus the UCC should not apply to the contract. In reviewing the decision of the trial court, the court searched for any obvious error on the part of the trial court.

In *Bonebrake v. Cox*, 499 F.2d 951 (8th Cir. 1974), it was first noted that the appropriate test for contracts of a hybrid nature was the predominant purpose test. The test states that courts should look to whether the predominant factor or purpose behind the contract is either the purchase of a service with incidental goods or the purchase of goods with incidental services. If the purchase of goods is the predominate element, then Article 2 applies to the contract. Later, in *Pass v. Shelby Aviation*, No. W1999-00018-COA-R9-CV, 2000 Tenn. App. LEXIS 247, 2000 WL 388775 (Tenn. Ct. App. April 13, 2000), Tennessee officially adopted the predominant purpose test. The *Pass* court determined that a contract to service a plane and replace some brackets was mainly one for services after examining the transaction as a whole. Additionally, the *Pass* court refined the predominant purpose test and added four factors to aid in its analysis: (i) the language of the contract; (ii) the nature of the business of the supplier; (iii) the

reason the parties entered into the contract; and (iv) the respective amounts charged for goods and services. The *Pass* court also noted that the party that seeks to apply the UCC bears the burden of proving the contract was for the sale of goods. While sculpting these factors, the *Pass* court looked to an Indiana Supreme Court case, *Insul-Mark Midwest, Inc. v. Modern Materials, Inc.*, 612 N.E.2d 550 (Ind. 1993). In *Insul-Mark*, the court stated that one important element in examining the language of a contract is the terms that the parties use to describe both their relationship and their performance.

After reviewing the case, the Tennessee Court of Appeals held that the contract at issue was for the sale of goods, and thus, the application of the UCC was appropriate. First, the court looked to the language of the contract describing the performance and the relationship between the parties—the first *Pass* factor. The court found that the plain language of the contract between AVA and Tanzer showed that this was a hybrid contract for both goods and services. Within the contract, Tanzer is referred to as the “purchaser,” which, according to *Bonebrake*, points to a contract for the sale of goods. Furthermore, the court stated that the repeated use of the word “equipment,” which *Bonebrake* notes is a term of art specific to goods, also points to the same conclusion. Tanzer tried to argue that, although he did contract for goods, the goods were installed into his home, forming a contract for construction. This was a successful argument in *Aluminum Vinyl Sales Co. v. Woerz*, No. 03A01-9304-CV-00172, 1993 Tenn. App. LEXIS 615, 1993 WL 367125 (Tenn. Ct. App. Sept. 20, 1993), and had this argument succeeded here, the contract would be outside the realm of the UCC; however, the court was unpersuaded because the fact that the goods in question remained movable even after their installation proved that this categorization was inappropriate, unlike the situation in *Woerz* where a patio finish was no longer removable from a home.

Second, the court examined the nature of AVA’s business—the second *Pass* factor. AVA sold various “smart home” components to its clients, but it also provided installation and servicing. The court determined that the installation and servicing of these components was simply incidental to their sale.

Third, the court explored the next *Pass* factor: the reason or purpose behind the contract. When examining this factor, a court is encouraged to look at the contract as a whole in order to determine what the purchaser was actually bargaining for. Here, the contract was for a fully integrated home electronic system, which in the opinion of the court was clearly a good.

Finally, the court examined the last *Pass* factor: the relative amount paid for the services and goods. In the case at issue, the cost of equipment accounted for approximately 82% of the total contract price, making the price for services

miniscule in comparison. Overall, each of the *Pass* factors supported the determination by the trial court that this contract had a predominant purpose of the sale of goods, and thus the UCC was properly applied.

This opinion is significant to transactional attorneys because it helped to clarify and refine the factors used to determine when to apply the UCC to hybrid contracts. This is important because, as technology develops, more parties will contract for products and upgrades that require both installation and maintenance. As a result, more contracts will be hybrid in nature, causing increased confusion over what legal standards should apply. The four factors used in Tennessee to determine the predominant purpose of a hybrid contract, otherwise known as the *Pass* factors, will help to clarify where the UCC applies.

The main lesson to be learned here is that careful drafting is key. If attorneys are well aware of the *Pass* factors, they can anticipate these issues and draft their contracts with language that supports their client's position and preferred choice of law. Cases such as this one show that courts are telling attorneys exactly what to do and how to prepare. Ultimately, transactional attorneys have the power to determine what law controls their contracts as long as they know the laws, plan ahead, and draft accordingly.

CONTRACTS

Under Tennessee law, in a corporate contract, naming the corporation represented and using the word “by” immediately before a corporate officer’s signature, and then following the signature by immediately naming the office held by the signator gives rise to a presumption that the signator is signing only in a representative capacity. *Creekside Partners v. Scott*, No. M2012-00623-COA-R3-CV, 2013 Tenn. App. LEXIS 14; 2013 WL 139573 (Tenn. Ct. App. Jan. 10, 2013).

By Jacob Spangler

In *Creekside Partners v. Scott*, the Tennessee Court of Appeals considered whether the trial court erred in holding that a corporate president's signature on a commercial lease did not personally obligate him as a guarantor of the corporation's undisputed obligation to pay rent, even though parts of the lease suggested that the signator would become a guarantor. The court found that the trial court had not erred in its holding, and accordingly affirmed the decision, absolving the president of personal liability.

In 2007, Creekside Partners (“Creekside”) and NTS Enterprises (“NTS”) entered into a commercial lease agreement under which Creekside would lease a piece of commercial real estate to NTS for a term of 124 months, with NTS agreeing to make monthly rent payments. NTS took possession of the property and paid the amounts due under the lease for nearly two years, but then became delinquent in payment. In fact, NTS failed to provide full and timely payments for six consecutive months in 2010. In response, Creekside terminated the lease in August 2010, but NTS remained in possession of the property until the end of May 2011, continuing to pay only partial rent.

The lease agreement was signed by representatives of both corporations. Albert Nathan Scott (“Scott”), president of NTS, signed on behalf of NTS. The only signatures in the nineteen-page lease agreement appear on the signature page—page fourteen of the document. The signature page opens with the following statement of intent: “IN WITNESS WHEREOF, the undersigned Tenant, Landlord, and *Guarantors* have executed this Lease the day and year first above written.” (emphasis added). On the line where Scott signed the page, his signature is immediately preceded by the word “by” and immediately followed by naming his office as “President,” in the following form:

By: _____ /s/ _____

Name: A. Nathan Scott

Its: *President*

Creekside filed an action against NTS and Scott in June 2011 to recover the unpaid rent, alleging that Scott was personally liable as a guarantor of NTS’s obligations. Creekside contended that Scott was a guarantor pursuant to Article 32 of the lease, which appeared on page twelve of the document and read as follows:

In consideration of the letting of the Premises, the sum of TEN DOLLARS (\$10.00) and other good and valuable consideration, receipt of which is hereby acknowledged, the undersigned Albert Nathan Scott, does hereby guarantee and become primarily liable as a co-Tenant(s) do(es) [sic] hereby promise and agree to pay unto the Landlord, its successors and assigns, such sum or sums of money as will be sufficient to make up such deficiency and fully satisfy the conditions of the Lease.

Scott’s answer to the complaint admitted that NTS was liable for its failure to pay, but denied any personal liability as guarantor. At a hearing in October 2011, the trial court announced that it would postpone its decision in light of the Tennessee

Supreme Court's anticipated ruling in the case of *84 Lumber Co. v. Smith*, 356 S.W.3d 380 (Tenn. 2011), which addressed a similar issue.

After the decision in *84 Lumber* and arguments, the trial court held in favor of Scott, finding that the arrangement of terms on the signature page, particularly the naming of Scott's office as president, created a presumption that Scott was signing only in a representative capacity, rather than in a personal one. Furthermore, the trial court found "no indication anywhere in the form of [Scott's] signature" that he had intended to sign as an individual and make himself a guarantor. Creekside appealed, arguing that the trial court misinterpreted the decision of *84 Lumber*.

84 Lumber used two rules of law that are critically important to the court's decision in *Creekside*. First, while a representative who signs a contract is typically not personally bound by it, the representative may be personally bound "when the clear intent of the contract is to bind the representative." Second, to determine what the clear intent of the contract is, courts look to "the ordinary meaning of the language contained within the four corners of the contract." These rules provide the backdrop for the *Creekside* decision.

On appeal, the Tennessee Court of Appeals held that using the word "by" immediately before a corporate officer's signature and immediately following the signature with a designation of the office held by the signator gives rise to a presumption that the signator is merely signing in a representative capacity, and not in a personal one. The court cited dicta in the Tennessee Supreme Court case of *Cone Oil Co. v. Green*, 669 S.W.2d 662 (Tenn. Ct. App. 1983), as its authority for this determination. While the defendant in *Cone Oil* was held liable as guarantor, the guaranty provision in that case was found in an entirely separate document from the original agreement. The court mentioned that, had the signator in *Cone Oil* signed the agreement in the same "by: [signature] [designation of corporate office]" form, the court would have presumed the defendant not liable as guarantor. The defendant in *84 Lumber* was held liable as guarantor for similar reasons, as the guaranty provision was clear and unambiguous from the signature page and distinguished between "I" the individual and "the above business" as the business being represented by the signature.

The court distinguished the present case from *84 Lumber* by looking at the contracts in each case. While the guaranty provision and personally binding language in *84 Lumber* was held to be consistent and unambiguous, the court could not say the same for the contract between Creekside and NTS. In *84 Lumber*, the guaranty provision was typed in all capital letters, set off from the rest

of the text on the page, and followed by a signature on the same page. The present contract's guaranty provision was in the same font size as the rest of the text and was separated from the only signature—signed merely in a representative capacity—by two entire pages. Also, unlike the contract in *84 Lumber*, the agreement at issue seemed confused about Scott's actual role in the agreement. Article 32 of the agreement, which Creekside primarily relied upon in its argument, designated Scott as a "co-Tenant." However, both Scott and NTS are referred to as "co-Tenant," "Tenant," and "the Tenant" interchangeably throughout the document. Finally, page eleven of the agreement featured a blank for the addresses of any applicable guarantors. No address was provided on this page.

Amid these seeming inconsistencies, the court found no "clear intent" to make Scott a guarantor in the contract, and thus declined to hold him personally liable. Scott signed only in a representative capacity, and whether he intended to make himself a guarantor of NTS's obligations under the lease could not be clearly derived from the document.

Transactional attorneys in Tennessee should take note of this decision when drafting contracts. First, using the word "by" to precede a signature and following the signature with a designation of the signator's corporate office will almost always signify a merely representative signature. The individual who signed the contract will most likely not have signed in a personal capacity. When drafting contracts, attorneys should be mindful to either avoid or use this format, depending on whether their wish is to impose a personal obligation on the person who signs the document.

Second, attorneys should pay careful attention to their party designations. The court used Creekside's ambiguous use of the terms "co-Tenant" and "Tenant" against it in this decision. When revising a form contract for a new agreement, attorneys should meticulously review the documents to make certain that the intended party designations are used throughout. Finally, attorneys would be well advised to make guaranty provisions abundantly clear and obvious. The mere inclusion of a guaranty provision was not enough to bind a guarantor in *Creekside*. Guaranty provisions are more likely to be upheld if they are set apart from the rest of the document instead of seated indistinctly among the other provisions of the contract.

CONTRACTS

Under Tennessee law, a mandatory arbitration provision in a contract may be invalidated if the court finds that the contract was never formed in the

first place or if the provision is part of an unconscionable contract of adhesion. *Webb v. First Tenn. Brokerage, Inc.*, No. E2012-00934-COA-R3-CV, 2013 WL 1737202, 2013 Tenn. App. LEXIS 276 (Tenn. Ct. App. Apr. 23, 2013), *withdrawn and superseded by* 2013 WL 3941782, 2013 Tenn. App. LEXIS 396 (Tenn. Ct. App. June 18, 2013).

By Michael Hromadka

The Tennessee Court of Appeals addressed the enforceability of mandatory arbitration provisions in *Webb v. First Tennessee Brokerage, Inc.* The court addressed this issue with the knowledge that many companies today prefer arbitration to litigation and will accordingly include arbitration provisions in their contracts. After scrutinizing the alleged contract containing the arbitration provision, the court affirmed the trial court's finding that the provision was unenforceable because a contract was never formed in the first place, and even if one had been formed, the provision would have been part of an unconscionable contract of adhesion.

In *Webb*, Franda Webb ("Ms. Webb") sought investment advice from a financial advisor named Michael Conaty ("Mr. Conaty") at First Tennessee Brokerage, Inc. ("FTBR"). Ms. Webb told Mr. Conaty that, even though she was looking for a higher return than traditional low-risk investment options, any principal she invested must remain secure in order to pay for the special educational needs of her son. Mr. Conaty told Ms. Webb that he would explore investment options.

Mr. Conaty called Ms. Webb on February 14, 2008, and suggested that she invest in Lehman Brothers bonds (the "Bonds"). Mr. Conaty told Ms. Webb that she had to purchase the Bonds that day because it was the final day of the Bond's initial public offering. Ms. Webb purchased the Bonds using all of her investment money. After purchasing the Bonds, Mr. Conaty claimed that Ms. Webb signed a contract called the "Brokerage Account Customer Agreement" (the "Customer Agreement") that included a mandatory arbitration provision. Ms. Webb, however, claimed that "she had never seen and did not receive an arbitration agreement . . . [and] that they had never discussed one."

Ms. Webb lost the majority of her investment when Lehman Brothers filed for bankruptcy six months after she purchased the Bonds. Ms. Webb initiated a lawsuit against FTBR and Mr. Conaty soon after. Mr. Conaty and FTBR immediately filed a motion to compel arbitration, citing the Customer Agreement.

At trial, the court denied the motion to compel arbitration for six reasons. First, the claims against Mr. Conaty were not arbitrable because he was not listed as a party to the Customer Agreement; therefore, he could not seek to enforce its terms with respect to the claims against him. Second, the Customer Agreement was unenforceable because it was an “unconscionable contract of adhesion.” Third, the agreement was unenforceable because it was induced by fraud. Fourth, Ms. Webb did not agree to the arbitration and FTBR could not provide the court with the Customer Agreement signed by Ms. Webb. Fifth, FTBR’s forms did “not contain any language where the customer expressly agrees to arbitrate.” Sixth, any claims by Ms. Webb’s son as a third-party beneficiary to the bond purchase agreement against Mr. Conaty were not arbitrable because the son was not a party to the Customer Agreement and “arbitration clauses are not binding on third parties who are not parties to the contract.”

On appeal, the court of appeals reexamined the trial court’s reasoning and affirmed that the mandatory arbitration provision was unenforceable because a contract was never formed in the first place. The court further held that, even if a contract did exist, it would have been unenforceable on the grounds that it was an unconscionable contract of adhesion.

First, the court held that the inclusion of a Tennessee choice-of-law provision in the Customer Agreement obligated the court to apply Tennessee law to invalidate the formation of the contract. FTBR argued that the arbitration provision should have been enforced because the Federal Arbitration Act (“FAA”) requires enforcement of arbitration provisions in commercial contracts affecting interstate commerce. The court dismissed this argument because Tennessee common law obligates state courts to scrutinize the formation of an alleged contract before analyzing any of its provisions, as demonstrated in *Frizzell Construction Company, Inc. v. Gatlinburg, L.L.C.*, 9 S.W.3d 79, 85 (Tenn. 1999). The court then determined that a contract was not formed in the first place, because it was not the intent of Ms. Webb to enter into a contract in which she was bound by arbitration.

Second, the court affirmed that the Customer Agreement was an unconscionable contract of adhesion, because it was presented on a take-it-or-leave-it basis without negotiation. Contracts of adhesion are unenforceable in Tennessee if they are unconscionable, as provided by *Buraczynski v. Eyring*, 919 S.W.2D 314 (Tenn. 1996). Factors for the unconscionability of a contract of adhesion in Tennessee were laid out in *Taylor v. Butler*, 142 S.W.3d 277, 285 (Tenn. 2004), and include “the relative positions of the parties, the adequacy of the bargaining position, the meaningful alternatives available to the plaintiff, and the existence of unfair terms in the contract.” The court applied the *Taylor* factors

and affirmed that the Customer Agreement was unconscionable because the agreement was signed under significant time constraints, Ms. Webb was not allowed to revoke the arbitration provisions within a reasonable time, FTBR was significantly more sophisticated in contracting than Ms. Webb, the arbitration provision was not contained in a separate document, there was no explanation of what arbitration was, and the costs of arbitration were higher than court costs. The court determined that, because the Customer Agreement was unconscionable, any provision contained within it was unenforceable.

Third, there was no proof that the alleged arbitration agreement ever existed. Ms. Webb claimed that she never received an arbitration agreement, and FTBR never produced a Customer Agreement signed by Ms. Webb. With conflicting testimony and without proof, the court affirmed that FTBR failed to “carry its burden of proof to show that Ms. Webb agreed to arbitrate.”

Finally, the court found that the Customer Agreement was unenforceable because it was procured by fraud. In Tennessee, as demonstrated by the case of *Baugh v. Novak*, 340 S.W.3d 372, 388 (Tenn. 2011), “[a] party making a fraudulent inducement claim has the burden of proving that the defendant (1) made a false statement concerning a fact material to the transaction (2) with knowledge of the statement’s falsity or utter disregard for its truth (3) with the intent of inducing reliance on the statement, (4) the statement was reasonably relied upon and (5) an injury resulted from this reliance.” The court found that these elements were met when Mr. Conaty made the false statement that the Bonds *had* to be purchased on February 14, 2008, merely so that he could profit off making the sale before the initial public offering ended, even though he knew the Bonds could later be purchased on the secondary bond market. Ms. Webb relied on this statement to her detriment because she hastily bought the Bonds without considering diversification, later losing most of her investment. The court of appeals affirmed that agreements procured by fraud are unenforceable; consequently, arbitration provisions found within agreements procured by fraud are also unenforceable.

Transactional attorneys can increase the likelihood that their arbitration provisions will be enforced by using the drafting techniques suggested in *Webb*. First, drafters should include a provision stating that both parties agree that the contract involves interstate commerce and that the arbitration clause is irrevocable and enforceable pursuant to the FAA. Second, arbitration provisions should be extracted from contracts and placed in their own stand-alone agreement. Courts are more likely to enforce a stand-alone arbitration agreement because it is more conspicuous, and parties waiving their right to a jury trial are

ostensibly more likely to read and ask questions about a short, stand-alone agreement. Any stand-alone arbitration agreement should require the signatures of both parties, provide a definition of what arbitration is and how it works, affirm that both parties have negotiated to include the agreement, and should not be signed under compelling time constraints. Third, attorneys should ensure that clients keep a copy of all executed arbitration agreements in order to produce them as evidence at the court's request.

Shortly after *Webb* was decided, the court of appeals withdrew the opinion and superseded it with 2013 WL 3941782, 2013 Tenn. App. LEXIS 396 (Tenn. Ct. App. June 18, 2013). The unenforceability of the mandatory arbitration provision was still affirmed in the superseding opinion, and the reasoning supporting this affirmation was unchanged. However, the new opinion "vacate[d] any findings that [went] to the merits of the underlying case and remand[ed] for further proceedings."

EMPLOYMENT

Under Tennessee law, a plaintiff moving for summary judgment on a separation-payment claim must disprove any defense of acquiescence or waiver raised by the defendant. *Keith v. Jackson*, No. E2012-01056-COA-R3-CV, 2013 WL 672491, 2013 Tenn. App. LEXIS 120 (Tenn. Ct. App. Feb. 22, 2013).

By Kevin Davis

In *Keith v. Jackson*, the Tennessee Court of Appeals considered whether the parties to an employment contract intended the plaintiff's acceptance of a new job to replace the separation payments due to him. Specifically, the court considered if there was a genuine issue of material fact as to whether the plaintiff waived his right to separation payments when the employment contract provided that the plaintiff be paid separation payments, and the plaintiff accepted a job with a company that bought out his former employer. The court held that it was possible for the plaintiff to have waived his right to separation payments because no evidence from the record showed that the parties could not have agreed that the plaintiff's new job served as his termination compensation in lieu of the separation payments.

This case began when Roy W. Keith ("Keith") sued Michael J. Jackson, Sr. and Nata M. Jackson (the "Jacksons"), alleging that the Jacksons failed to pay him separation payments as provided for in an employment contract. Prior to the lawsuit in September 2008, Keith contracted with EcoQuest Holding

Corporation, Inc. and several other companies (collectively, the “Companies”) for legal employment. The Jacksons as limited guarantors of the separation payments signed the contract. As a part of the employment contract (the “Agreement”), Keith was required to serve as in-house counsel. In return, the Companies were to compensate Keith by paying him \$90,000 as a signing bonus and \$185,400 as an annual base salary.

Furthermore, the Agreement laid out guidelines for its termination. For instance, the Agreement defined three different categories of acceptable termination: general termination, termination for cause, and termination without cause. First, the Agreement defined general termination as a termination caused by the expiration of the contract, mutual agreement between Keith and the Companies, Keith’s death, or Keith’s disability. Second, the Agreement defined termination for cause as termination caused by Keith’s malicious misconduct or Keith’s voluntary resignation. Third, the agreement defined termination without cause as any termination that is not listed as general termination or a termination for cause.

Not only did the Agreement define the types of termination, it detailed each party’s duties following termination. If termination without cause occurred, the Agreement provided that the Companies were to compensate Keith with separation payments. Specifically, the Companies were obligated to pay Keith “all accrued but unpaid wages through the termination date” and Keith’s current base salary for the remainder of the contract term. Furthermore, the Agreement held the Jacksons secondarily liable for Keith’s separation payments because the Jacksons served as limited guarantors of the Agreement. The Jacksons were obligated to pay Keith his base salary for one year minus his signing bonus, in the event that the Companies did not.

In March 2009, another company by the name of Aerus Holdings, Inc. (“Aerus”) bought out the Companies. During this transition of ownership, Keith argued that the Companies terminated him without cause before he accepted employment at Aerus. Subsequently, Keith brought suit against the Jacksons, alleging that they failed to pay him separation payments. The Jacksons responded by arguing that Keith forfeited his right to separation payments because he continued work with Aerus. Subsequently, Keith moved for summary judgment, which the Jacksons opposed. The Jacksons also moved to amend their answer, which the trial court granted. Their amended answer listed several affirmative defenses such as acquiescence and waiver. The trial court granted Keith’s motion for summary judgment and required the Jackson’s, jointly and severally, to

compensate Keith in the amount of \$95,400. As a result, the Jacksons appealed to the Tennessee Court of Appeals.

On appeal, the Tennessee Court of Appeals held that the trial court erred in granting summary judgment because Keith failed to negate the Jacksons' defense of waiver. In reaching its decision, the court first considered whether the intention of the parties was for the Jacksons to pay Keith separation payments. Recognizing that the intent of the parties was based on the ordinary meaning of the Agreement, the court noted that if separation payments were definite and undisputed based on the language of the Agreement, then there was no genuine issue of material fact as to separation payments. On the other hand, if the language regarding the separation payments was unclear and questionable, then there was a genuine issue of material fact. Applying this standard, the court found that there was no genuine issue of material fact as to the Jacksons' obligation to make separation payments to Keith because the Agreement stated that the Jacksons as limited guarantors were to pay Keith upon the termination of the Agreement.

However, the court recognized that where defendants have raised a defense of waiver, a plaintiff should not be granted summary judgment based solely on the language of the contract unless they have negated the defense. Therefore, the court considered the Jacksons' argument that the trial court erroneously granted summary judgment because Keith failed to disprove that he waived his right to separation payments. Reviewing whether the waiver was a genuine issue of material fact, the court turned to Tennessee law on acquiescence and waiver. The court found that acquiescence occurs when a person expressly or "implied[ly] consent[s] to an act." The Court further recognized that acquiescence and waiver occur when "a person knows or ought to know that he or she is entitled to enforce his or her right to impeach a transaction and neglects to do so for such a time as would imply that he or she intended to waive or abandon his or her right."

Applying these definitions of acquiescence and waiver to the case at bar, the court recognized that Keith and the Companies could have reached an agreement in which Keith would be compensated by serving as in-house counsel for Aerus in replace of the separation payments. The court based its decision on the fact that nothing in the record such as the Agreement or even Keith's testimony negated the possibility that Keith waived his right to separation payments by accepting a similar, legal position with Aerus. Thus, the court found that the Jacksons' defense of acquiescence and waiver was an issue that had not been resolved upon summary judgment. The court held that the trial court erred in granting summary judgment because it was possible that Keith expressly or

impliedly agreed to waive his right to separation payments in order to obtain employment with Aerus.

In light of the court's decision in *Keith*, transaction attorneys should be cognizant of the fact that even though employees may be entitled to separation payments under an employment contract, the employees may waive such payments by agreeing to accept a similar position with a company that has bought out their former employer. In order for attorneys who represent clients claiming separation payments to move successfully for summary judgment, they must not merely argue that the four corners of the employment contract mention separation payments when defendants raise a defense of acquiescence or waiver. Rather, such attorneys must prove that their clients and their clients' former companies did not intend the clients' new jobs to replace separation payments. An attorney's failure to disprove acquiescence or waiver may result in a trial court's denial of summary judgment. Even if a trial court grants such a motion, failure to disprove a defense of waiver opens the doors for the defendant to appeal the case.

FRANCHISE LAW

Under Connecticut law, a company may only establish a franchise relationship under the Connecticut Franchise Act where more than 50% of its profits are derived from its relationship with the franchisor. *Echo, Inc. v. Timberland Machines & Irr., Inc.*, 661 F.3d 959 (7th Cir. 2011).

By Amanda Butterworth

The Connecticut Franchise Act (the "Act"), codified at section 42-133e of the General Statutes of Connecticut, limits the definition of a "franchise" to arrangements where the operation of the franchisee's business pursuant to a proscribed marketing plan or system is "*substantially associated* with the franchisor's trademark, trade name, logotype, advertising or other commercial symbol designating the franchisor or its affiliate." In *Rudel Machinery Co. v. Giddings & Lewis, Inc.*, 68 F. Supp. 2d 118 (D. Conn. 1999), the court held that the Act's "substantially associated" provision requires a plaintiff to show that "most, if not all, of its business derives from an association with the defendant" in order to establish a franchise agreement. In *Echo*, the United States Court of Appeals for the Seventh Circuit addressed whether a franchise relationship may be established

under the Act where less than 50% of the distributor's business results from its relationship with the supplier.

The *Echo* case arose out of the termination of a business agreement between Echo, Inc. ("Echo") and Timberland Machines & Irrigation, Inc. ("TMI"). TMI, a distributor of commercial and retail outdoor power equipment, began distributing products for Echo pursuant to a distributor agreement in 2004. In 2008, upon learning that TMI had encountered severe financial difficulties and was in a significant amount of debt, Echo decided to terminate the distributor agreement with TMI. TMI subsequently went out of business in 2009.

Following termination of the distributor agreement, Echo filed a breach of contract claim against TMI for failure to pay for products purchased from Echo. TMI then filed a separated claim and an identical counterclaim in the original case alleging, among other things, that Echo had violated the Act by terminating the distributor agreement without cause. The two cases were consolidated in the U.S. District Court for the Northern District of Illinois.

The district court granted summary judgment in favor of Echo on TMI's Connecticut Franchise Act claim after striking testimony offered by TMI. In TMI's response to Echo's motion, TMI relied heavily on an affidavit from its President and Secretary, Mark Zeytoonjian ("Zeytoonjian"), to establish a genuine issue of material fact regarding the existence of a franchise. The specific testimony in question was aimed at establishing that more than 50% of TMI's profits were derived from its relationship with Echo. The court granted Echo's motion to strike portions of the affidavit, finding that the affidavit offered expert testimony and Zeytoonjian had not been disclosed as an expert witness. The court considered the statements to be expert opinions on the grounds that the conclusions Zeytoonjian drew were based on his knowledge of accounting principles and that a layperson without such knowledge could not arrive at those conclusions. TMI contended that the testimony included mere factual statements based on Zeytoonjian's personal knowledge as the company's President and Secretary and should have been considered lay opinion testimony under Rule 701 of the Federal Rules of Evidence. As Zeytoonjian's statements were integral to TMI's ability to prove the existence of a franchise relationship under the Act, the exclusion of Zeytoonjian's testimony and the resulting grant of summary judgment were the central issues on appeal.

Under the Act, franchisors are prohibited from "terminat[ing], cancel[ing] or fail[ing] to renew a franchise, except for good cause." The *Echo* court emphasized that the Act's purpose is to prevent franchisees from going out of business due to an unexpected termination of a franchise agreement. Quoting *Grand Light and Supply Co. v. Honeywell, Inc.*, 771 F.2d 672 (2d Cir. 1985), the court

noted that “where a franchisee is completely dependent on the public’s confidence in the franchised product for *most or all* of his business, abrupt severance of the franchise tie, without good cause and without sufficient notice, could spell ruination.” This language was the original basis for establishing a threshold of greater than 50% of business derived from the franchisor in order to establish a franchise relationship; however, no court had established an express rule requiring this threshold under the Act.

On appeal, the United States Court of Appeals for the Seventh Circuit upheld summary judgment in favor of Echo on the Connecticut Franchise Act claim, holding that TMI did not establish that sales from its relationship with Echo constituted more than 50% of its business. Under de novo review, the court analyzed the relevant portions of Zeytoonjian’s testimony and held that the district court did not err in striking this testimony. Although the court reviewed the distinctions between expert and lay testimony, as urged by TMI, such analysis was ultimately not central to the court’s ruling. The first portion of stricken testimony included Zeytoonjian’s opinion that profits from one of TMI’s divisions should not be included in the gross profits calculation because that division was unprofitable. Relying on *Zenith Electronics Corp. v. WH-TV Broadcasting Corp.*, 395 F.3d 416, 419-20 (7th Cir. 2005), the court found that, regardless of whether the testimony was classified as expert or lay, the portion in question must be stricken simply because it consisted of Zeytoonjian’s “say-so” rather than an analysis of any sort. The second portion of stricken testimony included Zeytoonjian’s assertion that certain retail sales numbers should be included in TMI’s sales of Echo products because, although TMI did not directly sell those products, it facilitated and earned a commission on the sales. Although this portion of the testimony may have been proper lay testimony given Zeytoonjian’s position as President and Secretary, the court found that “in light of the Act’s purpose, it ma[de] little sense to include the [retail] sales figures in TMI’s sales of Echo products, as TMI did not benefit from the full sales price of those products.” Therefore, the court found that TMI failed to offer evidence of gross sales sufficient to prove a franchise relationship with Echo, and the district court properly granted summary judgment on the Connecticut Franchise Act claim.

TMI additionally urged the court to find that a franchise relationship existed on the sole basis that it went out of business following termination of the agreement, thus establishing the requisite substantial association; however, the court rejected this argument. While the court noted that *Hartford Electronic Supply Co. v. Allen-Bradley Co., Inc.*, 736 A.2d 824, 837 (Conn. 1999), suggests that the

likely result of termination or disassociation may be an appropriate consideration in determining the association of the parties, the court went on to state that “no court has ever relied solely on the fact that a company went out of business to conclude that a franchise relationship existed.”

Following this decision, transactional attorneys should be aware that a company must show evidence that more than 50% of its profits are derived from its relationship with a franchisor in order to establish a franchise relationship under the Act. Under this holding, the profits used to establish the 50% threshold must be derived directly from sales in which the franchisee receives the benefit of the full sales price and cannot include sales where only commissions are earned. This will make it harder for plaintiffs’ attorneys to state a claim for violation of the Act where a substantial portion of a company’s profits are derived from the franchisor, but the gross sales calculations do not exceed the 50% threshold. Additionally, a plaintiff will be unable to establish that it is “substantially associated” with a franchisor solely based on evidence that it went out of business following termination of an agreement, as the *Echo* court gave no credence to this argument. Although the *Echo* holding applied specifically to the Connecticut Franchise Act, this case may also hold persuasive value for courts interpreting substantially similar state franchise acts where the definition of “substantially associated” has not been addressed, thus expanding the number of attorneys who may be affected by this decision.

INTELLECTUAL PROPERTY

To protect software programming, the creator must look at patent law in addition to copyright law. *Oracle America, Inc. v. Google Inc.*, 872 F. Supp. 2d 974 (N.D. Cal. 2012).

By Gregory Goodman

The United States District Court for the Northern District of California, in *Oracle America, Inc. v. Google Inc.*, addressed whether Oracle America, Inc. (“Oracle”) had a valid copyright claim against Google Inc. (“Google”) related to Google’s Android platform or whether the work at issue fell under the exclusions of § 102(b) of the Copyright Act (the “Act”). *Baker v. Selden*, 101 U.S. 99 (1879) is the framework case in determining whether a plaintiff is appropriately asserting a claim to a copyrighted work, or whether the plaintiff should be asserting an exclusive right to a functional system, process, or method of operation under patent law instead. The Supreme Court in *Baker* pointed out that only patent law can give an exclusive right to a method. In an effort to simplify this issue,

Congress codified a limitation on the scope of copyright protection that is based on the holding in *Baker*. The Act, in § 102(b), explicitly excludes “any idea, procedure, process, system, method of operation, concept, principle, or discovery, regardless of the form in which it is described, explained, illustrated, or embodied in such work.” Congress also recognized the difficulty in applying copyright law to computer software and established the National Commission on New Technological Uses of Copyrighted Works (“CONTU”). CONTU decided that the fine line between the copyrightable form of a program and the uncopyrightable process the program represents should be determined on a case-by-case basis in the federal courts.

In 2005, Google set out to develop a smartphone platform using a programming language known as Java. Google entered into negotiations with Sun Microsystems, Inc. (“Sun”), the developers of the Java language, platform, and application programming interfaces (“API”), in an attempt to acquire a license to use and adapt the entire Java platform for use in mobile devices. Unfortunately, the two companies were unable to reach a deal after months of negotiations. Still determined to create a mobile platform using Java, Google designed its own platform and API which included its own implementations of the functions in the Java API that were required to adapt Java to a mobile platform. Google named this platform “Android.”

Google released the Android platform in 2007 and made it available to the public. Three years later, Oracle acquired Sun and thus acquired Sun’s rights to Java. At this point, Oracle filed suit against Google, claiming that aspects of Google’s Android platform infringed upon Oracle’s copyrights related to Java.

In the Java platform, a program is broken down into three categories of information. The highest category of the program is called a “package.” The court describes a package as being very similar to a folder. Each package holds the next highest category of information, which is called a “class.” Classes are prewritten programs that contain many subroutines called “methods.” In the Java platform, there are 166 packages, 600 classes, and 6000 methods.

Google created 168 packages for its Android platform. Of the 168 packages, Google replicated 37 from the Java platform to allow interoperability for programmers who use the Java language. All parties agreed that Google created its own implementations of these 37 packages, but Oracle claimed that Google replicated the structure, sequence, and organization of the overall code in the packages. Overall, only three percent of the code located in the 37 packages of the Android platform were replicated from Java. This three percent essentially

contained the methods, method specifications, and functionality of the packages. A significant point here is that the structure of Java dictates that, because there is only one way to call a particular method, every person wishing to use that method must use the exact same method specification. Google included these packages and method specifications to ensure interoperability for Java programmers.

The district court used four principles of copyright law to decide whether Oracle had an appropriate copyright claim. The merger doctrine, which was established by the Supreme Court in *Baker*, was the first principle. The merger doctrine states that if there is only one way to express something, then that expression is not protected by copyright law. The second principle merely states that names and short phrases are not protected by copyright law. The third principle of law that the district court applied was § 102(b) of the Act, which states that “copyright protection never extends to any idea, procedure, process, system, method of operation or concept regardless of its form. Functional elements essential for interoperability are not copyrightable.” The final principle applied in this case was established under *Feist Publications, Inc. v. Rural Telephone Service Co.*, 499 U.S. 340 (1991). The Supreme Court in *Feist* expressed that copyright protection is not a reward for an investment of time or creativity in a body of intellectual property.

After reviewing all of the evidence, testimony, and applicable law, the district court held that the elements replicated by Google were not protected by copyright law and that Google, and all others, were free to use the specific elements at issue under the Act. First, the court looked at whether the Act allowed a claim of ownership to a particular function of a method used in the Java API. The court decided that, as long as the party implementing the method writes its own code to do so, it is free to carry out the exact same function. More specifically, the court held that “under the Copyright Act, no matter how creative or imaginative a Java method specification may be, the entire world is entitled to use the same method specification (inputs, outputs, parameters) so long as the line-by-line implementations are different.” Furthermore, the court held that, because the method specifications in the Java language must be identical for interoperability, the merger doctrine applied. However, the court noted that, if Java’s structure did not require the method specifications to be identical, and there were other ways of reaching the same result, copyright law may convey ownership of any creative form not excluded by § 102(b) of the Act.

Second, the court addressed Oracle’s argument that the way Google grouped its methods in an identical manner to Java was not required by the structure of Java and therefore infringed on a copyrightable aspect. The court refuted the argument with two principles of copyright law. First, the court

pointed out that the organization of the Java names and methods were a “structure for a system or method of operation of the [API]” and was therefore excluded from copyright protection by statute. Second, the court found that Google needed to organize the methods in an identical manner to ensure interoperability among platforms. The Act specifically allows for the duplication of functional elements that are required for interoperability. Therefore, Oracle’s claim of copyright infringement was dismissed.

The district court repeatedly noted that the facts in this case, at the very least, touched on patent law issues. The court specifically stated that the issue in this case was whether this claim should be brought as a copyright issue or if patent law would better address the specific facts of the claim. The Supreme Court in *Baker* explained that the Patent Office, after a close examination, may provide an exclusive right to methods and operations, but it is the only office available to do so.

In light of this decision, transactional attorneys should consider obtaining a patent on valuable methods and functionality within computer programs to protect any code that is not protected by copyright law. While copyright law may apply to certain aspects of a program’s code, many important elements may be deemed to not be protected under copyright law. With power given to the federal court system to decide on a case-by-case basis what is copyrightable and what is not, the uncertainty is too great to assume an entire program is protected by the Act. Had Sun obtained a patent on the systems and methods within the Java API, Oracle might have had a better claim of exclusive rights to the code at issue. A thorough attorney should take the time to obtain patents on the elements of the code which represent methods and operations in order to eliminate the uncertainty left by the application of copyright law.

INTELLECTUAL PROPERTY

The first sale doctrine of the Copyright Act applies to copies of a copyrighted work lawfully manufactured and purchased abroad which are later imported into the United States. *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351 (2013).

By Kyle Watlington

At issue in *Kirtsaeng v. John Wiley & Sons, Inc.* was the geographic scope of the “first sale” doctrine contained in § 109 of the Copyright Act (the “Act”) and

whether it protects a purchaser of copyrighted material that was lawfully manufactured abroad and brought into the United States by the purchaser. The petitioner argued that the scope of the first sale doctrine should have no geographical boundaries while the respondent argued that the first sale doctrine only applies to sales made within the United States.

During the course of receiving an education in America, the petitioner, Supap Kirtsaeng (“Kirtsaeng”), had friends and family in Thailand buy low price copies of foreign edition English-language textbooks and mail them to him in the United States where he would resell the textbooks for a considerable profit. The respondent, John Wiley & Sons, Inc. (“Wiley”), was the publisher and copyright holder of the academic textbooks at issue. In 2008, Wiley brought a federal lawsuit against Kirtsaeng for copyright infringement. Specifically, Wiley alleged that Kirtsaeng’s “unauthorized importation of its books and his later resale of those books amounted to an infringement of Wiley’s § 106(3) exclusive right to distribute as well as § 602’s related import prohibition.”

Under § 106 of the Act, the owner of a copyright is given certain exclusive rights to its work, such as the right to sell or otherwise transfer ownership of copies of the work. However, several sections contained within the Act limit these exclusive rights. At issue in this case was the limitation contained within § 109(a) of the Act, known as the “first sale” doctrine, which states, “[n]otwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title . . . is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.” The provision in § 106(3) of the Act states that an individual is forbidden from distributing a copy of a copyrighted work without the permission of the copyright holder; however, under § 109(a), once a copy has been lawfully sold or lawfully transferred, the purchaser of the copy can then dispose of that copy however it sees fit. As stated by the Supreme Court, “[i]n copyright jargon, the ‘first sale’ has ‘exhausted’ the copyright owner’s § 106(3) exclusive distribution right.” This limitation, or exception, to § 106(3) is what allows libraries to lend out books, stores to sell used products, and companies like eBay to operate. Wiley’s challenge of this doctrine’s application to international markets had the potential to thoroughly alter the way many individuals and businesses operate.

The Supreme Court faced a similar question about geographical limitations in *Quality King Distributors, Inc. v. L’anza Research International, Inc.*, 523 U.S. 135 (1998), when they were asked whether the Act barred importation of a copyrighted item that was originally and lawfully made in the United States,

exported, and then re-imported. The Supreme Court held that this practice did not violate the Act.

In *Kirtsaeng*, the Supreme Court held 6-3 that the first sale doctrine applies to copies of copyrighted works lawfully manufactured and purchased abroad which are then imported into the United States. The district court had held that the first sale defense did not apply to “foreign-manufactured goods.” The second circuit agreed with the district court, focusing on the language of § 109(a) that stated the first sale doctrine only applies to copies “lawfully made under this title.” According to the second circuit’s logic, this language imposed a geographic restriction on the exception.

The Supreme Court disagreed with this reading of the statute, stating that, “[i]n [its] view, § 109(a)’s language, its context, and the common-law history of the ‘first sale’ doctrine, taken together, favor a *non*-geographical interpretation.” The Supreme Court found it unlikely that Congress would have wanted to narrow the first sale doctrine in such a way that would threaten normal academic and commercial practices across the United States. Indeed, by analyzing the legislative history of the Act, as well as several other related factors, the Supreme Court was unable to find any substantial support for the argument favoring a geographic-based restriction. Any previous geographic limitations in the language of the statute had been taken out by Congress as the Act evolved.

Furthermore, the Supreme Court noted that “the ‘first sale’ doctrine is a common-law doctrine with an impeccable historical pedigree” before it was codified by Congress. When common-law doctrines are transformed into statutes, the Court presumes that Congress intended to preserve the essence of the common law. The common-law doctrine, making no reference to geographical restrictions, further strengthens the argument for not attaching a geographical restriction to the statutory version of the law. This interpretation follows past decisions made by the Supreme Court, particularly that of *Quality King*, where the Supreme Court also found no geographical restrictions on the first sale doctrine. The Court has never attached a geographical restriction to the first sale doctrine, and here, they have again clearly stated that there will be no such restriction.

Ultimately, this decision is of great legal interest to practicing attorneys but probably of little legal significance to their daily practice. Had the Court decided the case differently, it would have negatively affected businesses and individuals throughout the United States and potentially resulted in a tidal wave of litigation. As the Supreme Court pointed out, a geographical restriction of this

magnitude would require libraries to track down the copyright holder of texts that were decades old before they could lend out foreign books, automobile manufactures would face numerous problems getting certain copyrighted components into the United States, and retailers would have difficulty importing the billions of dollars of foreign goods that are brought into the country each year, just to name a few examples. However, since the Supreme Court did not apply this restriction, this case will most likely not alter the day-to-day practice of most copyright attorneys.

The first sale doctrine is a well-known and easy to follow exception to § 106 of the Act that has been integrated into the daily lives of consumers everywhere. Copyright attorneys that work for companies such as Wiley who wish to curtail the importation of copyrighted materials into the United States will have to find a way around the “first sale” doctrine. Some possible solutions could be the use of licensing agreements for materials sold outside the United States or propositioning the legislature for changes to the Act that would allow for a tighter control of the international market. Until such changes are made, businesses and individuals will be able to freely purchase copyrighted works found at cheaper rates in the international market.

SECURED TRANSACTIONS

For a secured party to effect a commercially reasonable disposition of collateral so as to win a deficiency judgment, the secured party must sufficiently comply with the notice provisions as outlined in the Tennessee Code Annotated sections 47-9-611 through -613. *Regions Bank v. Thomas*, No. W2011-02320-COA-R3-CV, 2013 Tenn. App. LEXIS 156, 2013 WL 791616 (Tenn. Ct. App. Mar. 4, 2013).

By Jamie A. Gordon

In *Regions Bank v. Thomas*, the Tennessee Court of Appeals reviewed whether a borrower materially breached its loan agreement with a bank, whether the bank acted in good faith when it accelerated the loan after the breach, and whether the bank’s actions waived its rights under the loan agreement and/or cured the default. However, the issue decided by the court that has the greatest potential significance for transactional attorneys was whether the guarantors of the loan received sufficient notice of the disposition of the collateral, thus making its sale commercially reasonable.

In October 2007, Regions Bank (“Regions”) filed an action against the guarantors of a business loan granted in 2004 to LGT Aviation, Inc. (“LGT”) for

the amount of \$2,351,700. The loan agreement included a promissory note secured by a 1981 Hawker 700-A twin engine aircraft (the “Aircraft”), an aircraft security agreement, an agreement to provide insurance on the Aircraft, and a notice of specific insurance requirements. In 2006, the insurance coverage on the Aircraft lapsed. Regions requested proof of insurance many times and repeatedly informed Mr. Thomas D. Thomas (“Mr. Thomas”), the sole shareholder and president of LGT, that the loan agreement required him to maintain insurance on the Aircraft and that failure to do so would constitute a default. After receiving no response to these correspondences, Regions informed LGT and its guarantors that it was accelerating all of LGT’s obligations and demanded immediate repayment of all amounts due by August 30, 2007. Regions filed its complaint after receiving neither a response nor any repayment from LGT.

While the action was pending, legal counsel for Regions sent several memos to LGT and the guarantors advising them that Regions had placed insurance on the Aircraft as permitted by the loan documents. The memos also advised LGT and the guarantors that Regions could exercise its rights “as a secured creditor to take possession of, store and sell the [A]ircraft and its engines which [were] pledged to secure the loan,” and that all of these actions would be chargeable to the guarantors. Regions subsequently repossessed the Aircraft, undertook repairs necessary for its sale, and sold it for the price of \$875,000. The trial court entered judgment in favor of Regions in September 2011, and the guarantors appealed.

On appeal, the Tennessee Court of Appeals affirmed the trial court’s holding that LGT materially breached the loan agreement, that Regions acted in good faith in accelerating the loan payments, and that Regions neither waived nor cured the breach by purchasing insurance for the Aircraft. However, the court reversed the trial court’s finding on the issue of sufficient notice of disposition of the Aircraft and held that, because the guarantors did not receive satisfactory notice of disposition, the sale was not commercially reasonable. Because the sale was not commercially reasonable, the court vacated Regions’ deficiency judgment and remanded the matter for further proceedings.

The trial court had found Regions’ various correspondences to LGT and the guarantors sufficient to provide notice of the disposition of the Aircraft. The rules for sufficient notice of disposition are outlined in the Tennessee Code Annotated sections 47-9-611 through -613. To be commercially reasonable, section 47-9-611 requires that the “notification must be reasonable as to the manner in which it is sent, its timeliness (i.e., a reasonable time before the

disposition is to take place), and its content.” Additionally, section 47-9-613(1) sets out the contents and the form required for proper notification of disposition, which includes information describing the debtor, the secured party, the collateral, the intended method of disposition, the option for an accounting of indebtedness and its cost, and the time and place of the planned disposition or the date after which disposition may take place.

The court of appeals found that Regions’ mention of its *right* and its *option* to take possession of the collateral, and stating that it *might* exercise its right to do so “was at best ambiguous with respect to whether, when, and by what means Regions intended to dispose of the [A]ircraft.” The court reasserted that the purpose of notice of disposition is to give the debtor the ability to participate in the sale of the collateral and to ensure that it brings a fair price. The court reasoned that nothing in the record suggested the guarantors had actual knowledge of Regions’ repossession of the Aircraft or of the attempts to sell it, and therefore had no opportunity to participate in the sale. Finding that this evidence weighed against the trial court’s previous decision on the issue, the court reversed and held that the sale of the Aircraft was not commercially reasonable. As a result, the court also vacated the deficiency judgment that the trial court had previously granted Regions and remanded the issue for additional discovery and further proceedings on the amount of deficiency, if any, to which Regions was entitled under Tennessee Code Annotated section 47-9-626(3).

While the Tennessee Court of Appeals did not establish a new standard in making its decision, it reemphasized the importance of adherence to the standards for notice of disposition and commercially reasonable sale as set out in Tennessee Code Annotated sections 47-9-611 through -613. More specifically, this decision highlights the repercussions practitioners could face by not following the guidelines. In the future, to sufficiently protect themselves in their dealings with defaulting debtors, transactional attorneys representing secured parties should make all communications with the debtor regarding intended courses of action following a default clear and unambiguous. One way in which attorneys can accomplish this clarity in communication is by strictly adhering to the required contents and the form provided by the Tennessee Code Annotated sections 47-9-613(1) and -614. Additionally, transactional attorneys representing debtors should be on notice that the secured party’s disposition of collateral may be considered commercially unreasonable if notification of the disposition does not seem sufficient under the previously mentioned sections of the Tennessee Code Annotated. If the notice of disposition is not reasonable, debtors can use this fact to possibly avoid the award of a deficiency judgment or to appeal a judgment for a deficiency that has been previously granted. In sum, the court’s decision means

that if a secured party's communications regarding the disposition of collateral are in any way ambiguous, the commercial reasonableness of the disposition may be subject to judicial scrutiny.

WILLS & ESTATES

Under Tennessee law, the pages of a will must bear the signature of the decedent for a court to declare the will valid. *In re Estate of Chastain*, 401 S.W.3d 612 (Tenn. 2012).

By John Pevy

The Tennessee General Assembly enacted the Execution of Wills Act in 1941, and through this legislation, defined the uniform manner for executing an attested will. Today, virtually these same rules, codified in Tennessee Code Annotated section 32-1-104, govern the execution of wills in the state of Tennessee. In the case of *In re Estate of Chastain*, the Tennessee Supreme Court decided whether a decedent satisfied this statutory requirement when he failed to sign a two-page will, but instead signed a one-page affidavit of attesting witnesses to the will.

Thomas Grady Chastain (the "Decedent"), died on November 6, 2009. After his death, his daughter, June Chastain Patterson ("Ms. Patterson"), filed to gain administration rights for the Decedent's estate on April 30, 2010. Ms. Patterson alleged that the Decedent died intestate, leaving her as his "sole surviving heir." In addition to this request, she sought a waiver of bond and inventory. The court granted all of Ms. Patterson's requests and issued letters of administration that same day.

In opposition, Trent and Adam Chastain (the "Chastains") filed a motion for bond, inventory, and accounting on the Decedent's estate on July 7, 2010. The Chastains accused Ms. Patterson of falsely claiming to be the Decedent's sole surviving heir. They also alleged that the Decedent had two predeceased sons, and that the laws of intestacy entitled the sons' six surviving issue to a share of the Decedent's estate.

On August 24, 2010, Ms. Patterson delivered a two-page document, dated September 4, 2004, and titled "Last Will and Testament" (the "Will"), to the court. The Will mentioned the issue of the predeceased sons, leaving them with the Decedent's knife collection and any remaining insurance money after his final

expenses were paid. Ms. Patterson received the remainder of the Decedent's estate under the Will.

The Decedent's initials were printed on the first page of the Will, as were those of three attesting witnesses. The three witnesses' signatures also appeared at the bottom of the second page of the Will, but surprisingly, the Will did not contain the Decedent's signature or even a signature line for the Decedent. Instead, Ms. Patterson produced a separate one-page document titled "Self-Proved Will Affidavit" (the "Affidavit"), which contained the signature of the Decedent as well as those of the three attesting witnesses.

Accordingly, the Chastains filed a motion for declaratory judgment on September 7, 2010, challenging the Will's validity because it lacked the Decedent's signature. In response, Ms. Patterson filed a petition to probate the Will, and the Chastains responded with a notice of contest, filed on November 17, 2010, questioning the Will's validity.

The trial court scheduled a hearing for February 9, 2011, to decide whether the Decedent properly executed the Will pursuant to Tennessee statutory proscription. This resulted in the trial court ruling that "the four corners of these documents [did] not make a will," that the Decedent's initials did not constitute a signature, and that the Decedent's signature on the Affidavit did not satisfy Tennessee's requirement of "strict compliance in the execution of wills."

Ms. Patterson was allowed to seek an interlocutory appeal. There, the Tennessee Court of Appeals ruled that the signed Affidavit sufficiently displayed the Decedent's intent to validate the Will. The appellate court thus held that the signature sufficiently satisfied Tennessee Code Annotated section 32-1-104. Ultimately, the Tennessee Supreme Court granted the Chastains' motion to appeal.

In its ruling, the Tennessee Supreme Court relied chiefly on the plain language of Tennessee Code Annotated section 32-1-104. According to the court, the statute mandates that, in order for a testator to validate a will, "[t]he testator may either sign the will in the presence of the attesting witnesses, or acknowledge a signature already made in the presence of attesting witnesses, or direct someone else to sign the will in the presence of the testator and of the attesting witnesses." Regardless of the aforementioned method chosen, the court makes it clear that it is essential for the testator's signature to appear somewhere on the will.

To determine how strictly to interpret this statute, the court deferred to previous Tennessee decisions, which the court stated "have consistently interpreted statutes prescribing the formalities for execution of an attested will as

mandatory and have required strict compliance with these statutory mandates.” The principles of law outlined by these cases provide that Tennessee courts will not validate wills where: (i) the attesting witnesses fail to sign in one another’s presence; (ii) where the attesting witnesses did not sign, but instead initialed each page of the will and later submitted a signed affidavit of their attestation; and (iii) where the attesting witnesses signed separately and then later acknowledged to the testator that they had signed.

The court held that, by signing the Affidavit but failing to sign the two-page Will, the Decedent did not satisfy the provisions of Tennessee Code Annotated section 32-1-104(1)(A-D). It reached this conclusion, reversing the court of appeals and reinstating the trial court’s ruling, for three reasons. Firstly, the court declined to include the Affidavit as a part of the Will based on language present in both the Affidavit itself as well as that found in the Tennessee statute governing these types of affidavits, Tennessee Code Annotated section 32-2-110. Instead, the court asserted that the statute only authorized the use of an affidavit of attesting witnesses to confirm a will in lieu of live testimony, in the event of an uncontested will. Because the Will was obviously contested, the court held that the Affidavit could not, by statute, confirm the Will. Furthermore, the court used the language of the Affidavit itself, which instructed that it be attached to the Will, to prove that even the Affidavit acknowledged its separation from the Will.

Secondly, the court determined that the Decedent’s signature on the Affidavit did not sufficiently signify his intent in order to validate the Will. Instead, the court noted that even if the Affidavit did attest to the Decedent’s intention, it would not serve to validate the Will. This results from the precedent set by *In re Estate of McFarland*, 167 S.W.3d 299, 302 (Tenn. 2005), which provides that a court will attempt to carry out the testator’s intent unless it clearly violates a law or public policy. In the present instance, were the Affidavit found to be proof of the Decedent’s intent, it would clearly oppose the legislature’s directive in Tennessee Code Annotated section 32-1-104(1)(A-D) that the Will be signed.

Finally, the court rejected Ms. Patterson’s plea that it adopt the doctrine of integration, whereby the Will and the Affidavit would be merged into one document. According to the court, in light of the fact that the legislature not only created a statutory framework delineating how to properly execute wills, but also upheld it for over seventy years in the face of strict court interpretations, it would be improper to amend that framework without legislative input.

Transactional attorneys executing wills in light of this decision should keep in mind just how precisely courts enforce the language of Tennessee Code

Annotated section 32-1-104. Unsurprisingly, the court refused to rule against seventy-one years of statutory precedent, and instead declared that an executed will must bear the testator's signature somewhere on the document. Therefore, when executing a will, an attorney should make sure that the witnesses and the testator sign the actual will document in each other's presence. As *In re Estate of Chastain* proves, signing an affidavit of attesting witnesses, but not the will document itself, will not satisfy Tennessee statutory requirements. To avoid this sort of confusion, and any potential malpractice actions, attorneys executing wills should simply make it a policy that the testator and witnesses sign together.